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In the Supreme Court of the United States

OCTOBER TERM, 1936

No. 74

AMERICAN TELEPHONE AND TELEGRAPH CO. ET AL., APPELLANTS

v.

THE UNITED STATES OF AMERICA, FEDERAL COMMUNICATIONS COMMISSION, AND NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS

ON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the United States District Court for the Southern District of New York (R. 561) is reported in 14 F. Supp. 121.

JURISDICTION

The decree of the District Court was entered March 24, 1936. (R. 584.) Petition for appeal

was filed April 6, 1936, and was allowed the same day. (R. 586, 594.)

Jurisdiction of this Court is conferred by Sec. 402 (a) of the Act of June 19, 1934, c. 652, 48 Stat. 1093 (U. S. C., Title 47, Sec. 402 (a)), and by the Act of October 22, 1913, c. 32, 38 Stat. 220 (U. S. C., Title 28, Sec. 47), as amended by the Act of February 13, 1925, c. 229, 43 Stat. 938 (U. S. C., Title 28, Sec. 345).

QUESTIONS PRESENTED

The attack upon the "original cost" provisions of the order of the Federal Communications Commission concerns the accounting prescribed for property already in public service which is acquired from another public utility, whether a controlled or independent company, and which the acquiring company uses or is about to use in telephone service. The order of the Commission provides that, in the case of such acquisitions, the cost of the property to the company which first dedicated it to public service shall be included by the acquiring company in one set of balance-sheet accounts, and the difference between such "original cost" and the amount paid for the property by the accounting company (whether in cash or other consideration) shall be credited or debited to another balance-sheet account, account 100.4. These and other related provisions give rise to the following questions:

(1) Whether the segregation of amounts represented by account 100.4 into a separate balance-

sheet account is so arbitrary as to be unauthorized by the Act and in violation of the Fifth Amendment. There is also involved the subsidiary question whether account 100.4 is a suspense account or, as its classification indicates, a telephone plant investment account.

(2) Whether a provision by virtue of which the Commission may, when appropriate, direct that amounts in account 100.4 be written off is so unreasonable as to be unauthorized by the Act and in violation of the Fifth Amendment.

(3) Whether the provision that amounts in account 100.4, after they have been subdivided according to their character, shall be written off, amortized, or other disposition thereof made, as the Commission shall direct, is unauthorized by the Act because the provision in question does not itself set forth the rules to be applied by the Commission in issuing these directions.

(4) Whether the failure to allow depreciation as such against amounts in account 100.4, even though the Commission may, in appropriate circumstances, permit an equivalent operating-expense charge, is so arbitrary as to be unauthorized by the Act and in violation of the Fifth Amendment.

(5) Whether the cost and trouble involved in complying with the original cost provisions is so burdensome as to constitute a violation of the Fifth Amendment.

Apart from the foregoing questions arising under the original cost provisions, the following further questions are presented:

(6) Whether the requirement that the charges to certain accounts shall be just and reasonable and that payments in excess thereof shall not be included in operating expenses is so arbitrary as to be unauthorized by the Act and in violation of the Fifth Amendment.

(7) Whether certain classifications of physical property are so indefinite as to be unauthorized by the Act and in violation of the Fifth Amendment.

STATUTE INVOLVED

Section 220 of the Act of June 19, 1934, c. 652, 48 Stat. 1078 (U. S. C., Tit. 47, Sec. 220), known as the Communications Act of 1934, provides in part as follows:

> (a) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this Act, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys.
>
> (b) The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property,

classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers shall not, after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses.

* * * * *

(d) In case of failure or refusal on the part of any such carrier to keep such accounts, records, and memoranda on the books and in the manner prescribed by the Commission, or to submit such accounts, records, memoranda, documents, papers, and correspondence as are kept to the inspection of the Commission or any of its authorized agents, such carrier shall forfeit to the United States the sum of $500 for each day of the continuance of each such offense.

(e) Any person who shall willfully make any false entry in the accounts of any book

of accounts or in any record or memoranda kept by any such carrier, or who shall willfully destroy, mutilate, alter, or by any other means or device falsify any such account, record, or memoranda, or who shall willfully neglect or fail to make full, true, and correct entries in such accounts, records, or memoranda of all facts and transactions appertaining to the business of the carrier, shall be deemed guilty of a misdemeanor, and shall be subject, upon conviction, to a fine of not less than $1,000 nor more than $5,000 or imprisonment for a term of not less than one year nor more than three years, or both such fine and imprisonment * * *.

* * * * *

(g) After the Commission has prescribed the forms and manner of keeping of accounts, records, and memoranda to be kept by any person as herein provided, it shall be unlawful for such person to keep any other accounts, records, or memoranda than those so prescribed or such as may be approved by the Commission or to keep the accounts in any other manner than that prescribed or approved by the Commission. Notice of alterations by the Commission in the required manner or form of keeping accounts shall be given to such persons by the Commission at least six months before the same are to take effect.

Other pertinent provisions of the Act are set forth in the Appendix, *infra,* pp. 71–74.

STATEMENT

This is an appeal from a decree of a specially constituted three-judge District Court dismissing, except in two minor particulars, a bill to set aside and enjoin an order of the Federal Communications Commission issued on June 19, 1935, to become effective on January 1, 1936, prescribing a uniform system of accounts for telephone companies subject to the Communications Act of 1934. The plaintiffs and intervening plaintiffs below are the American Telephone and Telegraph Company and 36 telephone companies controlled by it, which will sometimes be referred to herein as the Bell companies. (R. 2–3, 244–245, 335; Moody's 1935 Public Utilities Manual, pp. 82, 83, 94, 116.) The additional plaintiffs below are 7 telephone companies independent of the Bell system, but controlled by a single holding company, which group will sometimes be referred to as the Associated companies. (R. 237; Moody's 1936 Public Utilities Manual, pp. 2088–2089). All 44 plaintiffs have joined in the appeal. The facts and issues are the same as to both groups of appellants, except that the "original cost" provisions of the system of accounts prescribed by the Commission affect a very much larger proportion of the property of the Associated companies than of the Bell companies.

The present proceeding was instituted pursuant to Section 402 (a), *infra*, p. 73, of the Communications Act of 1934 (hereinafter sometimes referred

to as the Communications Act). This section provides that the statutory provisions relating to the enforcement or setting aside of orders of the Interstate Commerce Commission shall apply to suits to set aside orders of the Communications Commission (with exceptions immaterial here). Appellee, National Association of Railroad and Utilities Commissioners, representing the regulatory commissions of 46 states, which had taken part in the proceedings before the Communications Commission leading to the order under attack here, was allowed by the District Court to intervene as a party defendant in support of the Commission's order. (R. 266, 268, 271.)

Prior to the enactment of the Communications Act, the accounts of telephone companies engaged as common carriers in interstate communication were subject to regulation by the Interstate Commerce Commission under Section 20 (5) of the Interstate Commerce Act.[1] Section 220 of the Communications Act, which closely parallels the language of various subsections of Section 20 of the Interstate Commerce Act, conferred upon the Communications Commission authority to prescribe the accounts to be kept by such telephone carriers. The Communications Act repealed the

[1] This authority was first vested in the Interstate Commerce Commission when the Mann-Elkins Act of June 18, 1910 (36 Stat. 544), extended the definition of "common carrier", as used in the Interstate Commerce Act, to include telephone companies.

provisions of the Interstate Commerce Act relating to telephone companies, but provided that all outstanding orders of the Interstate Commerce Commission issued under these repealed provisions should continue in effect until modified or superseded by the Communications Commission (Secs. 602 (b), 604 (a)).

The Interstate Commerce Commission first exercised authority over telephone company accounts in December 1912, when it prescribed a uniform system of accounts effective January 1, 1913. (R. 19.) These accounting rules remained in effect, substantially without change, during the next 20 years. (*Ib.*) They were superseded by a revised system of accounts (sometimes referred to herein as the 1933 System of Accounts) promulgated by the Interstate Commerce Commission in November 1932 and effective, except as to very small companies, January 1, 1933. The order of the Commission prescribing these accounts and the accounts themselves are set forth in full in the record. (R. 345–456.) Certain objections to the accounts were filed by a number of State regulatory commissions. (R. 15–16.) The Interstate Commerce Commission, after the enactment of the Communications Act but before its effective date (Sec. 607), issued a report on these objections but no order. (R. 15–84.)

The Communications Commission authorized the filing of objections to the foregoing report of the

Interstate Commerce Commission; held a hearing on these objections; adopted a "draft of a Uniform System of Accounts" which it submitted to all interested parties; entertained exceptions to these accounting rules, which exceptions were considered at a conference with representatives of the telephone companies and of the state commissions; and on June 19, 1935, issued the order prescribing the system of accounts under attack in this case. (R. 91–92.) These accounts (hereinafter sometimes referred to as the 1936 System of Accounts) and the order putting them in effect are set forth in full in the record. (R. 85–220.)

The parties stipulated to submit the case for final decree upon the pleadings and the affidavits filed in support of and in opposition to plaintiffs' application for an interlocutory injunction. (R. 552–553, 559.) Five affidavits were so filed by the Bell companies (R. 307, 317, 324, 331, 334), one by the Associated companies (R. 457), six by the Communications Commission (R. 468, 484, 500, 523, 531, 544), and affiants for the Bell companies submitted rebuttal affidavits reaffirming certain of their original conclusions and statements (R. 553–557). All of the affidavits deal with the interpretation and effect of the 1936 System of Accounts.

The District Court unanimously held that the accounting rules prescribed by the Communications Commission are not, with two minor exceptions, arbitrary, unreasonable, or such as to deprive appellants of rights guaranteed by the Fifth

Amendment. (R. 561–572.) The court filed, pursuant to Equity Rule 70½, findings of fact (R. 573–578, 583–584) and conclusions of law (R. 578–583). The accounting provisions which appellants challenge have been stayed pending the appeal to this Court.

ARGUMENT

I

THE LIMITED GROUNDS UPON WHICH APPELLANTS MAY ATTACK THE ORDER OF THE COMMISSION

This Court has said that in a suit to set aside an order of the Interstate Commerce Commission the only questions which are open for review are whether there have been "violations of the Constitution, or of the power conferred by statute, or an exercise of power so arbitrary as virtually to transcend the authority conferred." *Kansas City Southern Ry. Co.* v. *United States,* 231 U. S. 423, 440. In such a proceeding the court may not "under the guise of exerting judicial power, usurp merely administrative functions by setting aside a lawful administrative order upon our conception as to whether the administrative power has been wisely exercised." *Interstate Commerce Commission* v. *Illinois Central R. R. Co.,* 215 U. S. 452, 470.

When the Commission is exercising delegated legislative power to prescribe the accounts to be kept by common carriers (*Interstate Commerce Commission* v. *Goodrich Transit Co.;* 224 U. S. 194), there is a wide range for the exercise of ad-

ministrative judgment and discretion with which the courts will not interfere by substituting their judgment for that of the administrative body. An attack upon an order prescribing accounts "is, and must be, rested at bottom upon the contention that the regulations embodied in it are so entirely at odds with fundamental principles of correct accounting as intrinsically to manifest an abuse of power.". *Kansas City Southern Ry. Co.* v. *United States, supra,* p. 444. The question presented is whether the regulations of the Commission "do violence to" generally accepted principles of accounting, that is, whether they are "so clearly contrary to these and other applicable principles that they should be set aside as being in excess of the powers conferred by Congress upon the Commission." *Ib.,* p. 447. It is not enough that the court is of the opinion that the accounting rule "ought to be" other than that prescribed; this is not "a sufficient ground to declare that the Commission had abused its power." *Ib.,* p. 456.

These principles have been recently reaffirmed and restated. In *Norfolk & Western Ry. Co.* v. *United States,* 287 U. S. 134, 141, involving the validity of an accounting order of the Interstate Commerce Commission, the Court said:

> Within broad limits that body's determination is necessarily beyond revision and correction by the courts. * * * Whether the Commission should make special classifications to fit exceptional cases lies within the

> discretion conferred, and courts ought not to be called upon to interfere with or correct alleged errors with respect to accounting practice. If we were in disagreement with the Commission as to the wisdom and propriety of the order, we are without power to usurp its discretion and substitute our own.

Since, as this Court said in the *Norfolk & Western* case (p. 143), the test of validity is whether the order is so "arbitrary and outrageous" as to "amount to an abuse of power", those vested with administrative authority to prescribe accounting rules may determine controverted questions in more than one way. In the present case the Interstate Commerce Commission expressed an adverse opinion upon certain accounting rules which the Communications Commission subsequently adopted, but it does not follow that the decision of the latter body is therefore "arbitrary and outrageous". That it is not, but is, on the contrary, well within the zone of reasonableness and therefore within the scope of administrative discretion would seem a fair inference from the fact that the order of the Communications Commission is actively supported (R. 562; Fg. II, R. 574) by an association representing some 46 state public utility regulatory bodies.[2]

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[2] The order of the Michigan Public Utilities Commission of December 3, 1935, referred to in the brief of additional appellants (p. 8), did not "reject" the 1936 System of Accounts. The order was entered after the filing of the present suit, which sought a stay order and temporary injunction

Appellants contend that the order of the Commission is so arbitrary that it amounts to a denial of due process. This suit was brought before the order had gone into effect. In large part the arbitrary characteristics of the order asserted by appellants rest upon disputed interpretations of the meaning of the order. If the Commission, in administering the order, adopts the meaning and interpretation which its witnesses place upon the order, most of the constitutional questions raised by appellants will never require adjudication. Unless or until the Commission adopts or threatens to adopt a construction of its order which might render it invalid, no constitutional right of appellants is infringed. "In the circumstances, no case is presented, either by pleadings or proof, calling on a fedeal court of equity to rule upon the correctness of some other construction which may never be adopted." *Edelman* v. *Boeing Air Transport, Inc.*, 289 U. S. 249, 253. This Court has rigidly adhered to the rule "never to anticipate a question of constitutional law in advance of the necessity of deciding it." *Steamship Co.* v. *Immigration Commissioners,* 113 U. S. 33, 39. See *Abrams* v. *Van Schaick,* 293 U. S. 188; *Wilshire Oil Co., Inc.* v. *United States,* 295 U. S. 100.

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against the 1936 System of Accounts. The order of the Michigan Commission merely revoked a prior order under which this System would automatically have become the accounting rules of the Michigan Commission.

II

THE ORIGINAL COST PROVISIONS ARE WITHIN THE COMMISSION'S STATUTORY AUTHORITY AND THEY DO NOT INFRINGE RIGHTS GUARANTEED BY THE DUE PROCESS CLAUSE OF THE FIFTH AMENDMENT

1. THE ORIGINAL COST PROVISIONS

The meaning, effect and purpose of the original cost provisions of the Commission's order will appear more clearly if the comparable provisions of the 1933 System of Accounts are first set forth. In this system a single balance-sheet account, 100, covers telephone plant. Account 100 is the total of the primary telephone plant accounts, 201 to 280, inclusive, and it includes both property in telephone service and that held under a definite plan for such service. (R. 378.) The primary telephone plant accounts include such intangibles as those represented by account 201, "Organization", and account 202, "Franchises"; they also include account 280, "Construction work in progress", and account 278, "Undistributed cost of property". (R. 393.) When property "in use in telephone service" is purchased from another public utility, the accounting is as follows: (1) the appropriate primary plant accounts are charged on the basis of land at "estimated current value", tangible personalty at "current cost new", franchises at "original cost", and construction work in progress

at "cost";[3] (2) depreciation and amortization reserves are credited with the estimated reserve requirements applicable to the plant; and the difference between the net of (1) and (2), on the one hand, and, on the other hand, the cost of the property to the accounting company is credited or debited to account 278. (R. 365–366.) To state the matter more simply, what goes into account 278 is the difference between the present value of the property acquired (franchises being valued at original cost) and the amount paid to acquire the property.

Since account 100 is the sum of the primary telephone plant accounts, one of which is account 278, under this system the full amount paid another utility for telephone property is included in the balance-sheet account covering telephone plant, irrespective of whether it is proper under sound accounting principles to capitalize the entire expenditure. Moreover, amounts entered in account 278 may continue there indefinitely whether such asset value as this investment may have originally represented continues to exist or not. This is so because amounts in account 278 are not subject to depreciation charges and because the accounting company is not required to amortize balances in

[3] In lieu of these charges, the accounting company may, with the approval of the Commission, charge to its primary plant accounts the amounts carried on the books of the vendor with respect to the property purchased. (R. 366.)

278 although it is given the option of doing so (account 413, R. 414) by debiting surplus.

Under this system the balance-sheet account representing telephone plant may be inflated by transfers between controlled companies, in which transactions price is a matter of indifference since they involve a mere shift of assets from the parent company's left hand pocket to its right hand pocket. (R. 536.) Furthermore, such transfers may be made the medium for writing up the primary telephone plant accounts, on which depreciation charges are based, to current cost new. The extent of such write-ups rests largely in the discretion of the accounting company. It is well known that appraisals of reproduction cost vary widely and appraisals made simply for the purpose of entering transactions on the books of account are not subjected to the check of adversary proceedings.[4] The fact that write-ups of this character are permitted destroys the trustworthiness of the accounts from the standpoint of investors and makes them unreliable for use in arriving at original cost of construction, a recognized relevant factor, to be considered along with other relevant factors, in determining value in rate litigation. *Smyth* v. *Ames,* 169 U. S. 466, 547; *McCardle* v.

[4] "Many so-called 'appraisals' are little more than estimates and the values obtained by them have no substantial basis." Montgomery, *Auditing Theory and Practice*, 5th Ed., p. 278.

Indianapolis Water Co., 272 U. S. 400, 410–411; *Los Angeles Gas & Electric Corp.* v. *Railroad Commission*, 289 U. S. 287, 306.[5]

The nature of the telephone business is such that it is, and for efficient operation must be, a territorial monopoly; in fact it is substantially a nation-wide monopoly. Accordingly, such telephone property as is acquired from another utility is usually acquired from a controlled or affiliated company.[6] The opportunities for possible abuse permitted by the 1933 System of Accounts in connection with such acquisitions is therefore a matter of primary importance.

Another defect in the 1933 System of Accounts is that there is no uniformity in the basis on which property is carried in the primary telephone plant

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[5] The phrase which this Court has used is "original cost of construction". In the case of property dedicated to the public service, cost at the time of first dedication (the Commission's definition of original cost) is the practical equivalent of original cost of construction. In the *Los Angeles* case cited above, where there had been no change in ownership, original cost of construction and cost to the owner were the same, and both forms of expression were used. Obviously, the amount which a *subsequent* owner pays to acquire property is not the same as original cost of construction.

[6] Of the total property acquired from other utilities by the Bell Companies since 1915, two-thirds has been acquired from companies, all or substantially all the stock of which was owned by Bell Companies. (R. 336.) The remaining one-third was acquired "partly from affiliated and partly from independent companies". (*Ib.*)

accounts and therefore no uniformity in the basis on which depreciation charges are computed. Property constructed by the accounting company or purchased from non-utilities is carried at cost. Property purchased from another utility since January 1, 1933, is carried either at reproduction cost new or at the amount shown on the books of the predecessor company. "Going or completed plant" purchased before January 1, 1933, is carried on varying bases, as indicated below.[7]

The 1936 System of Accounts splits up the balance-sheet account representing telephone plant into four balance-sheet accounts. Account 100.1 is limited to property "used in telephone service". Account 100.2, "Telephone plant under construction", represents a transfer of account 280 (1933 System) from the primary telephone plant accounts to a balance-sheet account. Account 100.3, "Property held for future telephone use", is a segregation into a separate balance-sheet account of telephone property not in use but held for such

[7] Instruction 13 (p. 33) of the Uniform System of Accounts for Telephone Companies, First Issue, effective January 1, 1913, provided that when a going or completed plant was purchased, the constituent elements should be charged to the appropriate plant accounts at structural value (estimated cost of reproduction less depreciation) if the consideration given exceeded total structural value; and that if the consideration did not exceed such value, it should be distributed through the accounts in proportion to the structural value of the constituent elements appropriate to the respective accounts.

use. (R. 123.) Property is to be carried in these three accounts, as well as in the primary telephone plant accounts, at "original cost", which is defined as the cost of the property "at the time when it was first dedicated to the public use, whether by the accounting company or by a predecessor public utility". (R. 101, 122–123, 144–156.) Such original cost and cost to the accounting company is the same except when property is acquired from another utility. In the case of such acquisitions the difference between cost to the accounting company and original cost (less depreciation applicable at date of acquisition) is credited or debited to balance-sheet account 100.4, "Telephone plant acquisition adjustment". (R. 123.)

As the District Court said (R. 567), account 100.4 "performs a function similar to" account 278. There is entered in each account the difference between the amount paid to acquire property from another utility and the amount which under the accounting rules is chargeable to primary telephone plant accounts. But the 1936 System of Accounts, in line with the other changes adopted for the purpose of rendering the balance-sheet statement more informative, makes the account a separate balance-sheet item instead of leaving it buried among the primary telephone plant accounts.

Paragraph (B) of 100.4 provides that the account shall be subdivided according to the character of the amounts contained therein and paragraph (C) provides (R. 124):

> The amounts recorded in this account with respect to each property acquisition shall be disposed of, written off, or provision shall be made for the amortization thereof in such manner as this Commission shall direct.

2. THE SEGREGATION OF AMOUNTS REPRESENTED BY ACCOUNT 100.4 INTO A SEPERATE BALANCE-SHEET ACCOUNT IS NOT ARBITRARY

Appellants assert (Br., p. 22) that the Commission's order requires accounts to be kept on a basis which will not show the accounting company's own actual costs, but the costs of some prior owner. We submit that the order does not have this effect. What it does is to require that, in the case of property already in public service acquired from another utility, the original cost of such property shall be shown in one set of balance-sheet accounts (100.1, 100.2, 100.3) and the difference between such original cost and cost to the accounting company in another balance-sheet account (100.4).

A public utility does not have a constitutional right to any particular classification of its property investment. *Norfolk & Western Ry. Co.* v. *United States*, 287 U. S. 134, 143. Appellants therefore have the burden of establishing that it is plainly unreasonable to segregate in a separate balance-sheet account the portion of their property investment represented by account 100.4. Appellants not only fail to sustain this burden, but the segre-

gation in question can be shown to be reasonable upon a number of grounds.

Purchases of going telephone property from another utility are, with rare exceptions, not purchases of individual articles, such as a coil of wire, a certain number of telephone poles, or a particular underground cable, but they are purchases of another company's entire assets or of its entire assets in a given territory. The amount paid in such acquisitions is always subject to the possibility of distortion if, as is usually the case, the property is acquired from a controlled or affiliated company, and in the case of acquisitions from independent companies there are so many extraneous factors affecting price (*infra,* pp. 34–38) that the amount paid is an unreliable index of the investment in telephone plant as such. To segregate in certain accounts the original cost furnishes investors with precise and accurate data as to the basis upon which the amount of the investment represented by these accounts is computed. To set forth separately on the balance sheet an account which represents the difference between the cost to the owner and original cost, where there is such a difference, likewise furnishes investors and other interested parties with more complete information than if this difference were concealed in a single balance-sheet account covering telephone plant. From the standpoint of correct accounting, account 100.4 appropriately belongs among the balance-sheet accounts. (R. 473.)

The segregation in question, in addition to being enlightening to investors, will also provide accurate, current data as to one of the factors ordinarily considered in a rate case. (*Supra*, pp. 17–18.) Certainly any accounting rule which tends to diminish the delays attendant upon rate litigation is eminently reasonable.[8] The classification therefore aids the Commission in performing more expeditiously one of the most important duties imposed upon it by the Act, the determination and prescription under Section 205 (a), *infra*, p. 71, of just and reasonable charges for the services rendered by carriers subject to the Act. The segregation is also in aid of the authority given to the Commission by Section 213, *infra*, p. 72, to value the property of carriers subject to the Act, paragraph (c) of this section authorizing it to require the carrier to file a statement showing "the original cost at the time of dedication to the public use" of the carrier's property.

Even if the reasonableness of the segregation were far less clear than it is, it would not transcend either the Commission's statutory authority or constitutional limits. In *Kansas City Southern Ry. Co.* v. *United States*, 231 U. S. 423, 456, this Court,

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[8] The rate litigation before this Court in *Lindheimer* v. *Illinois Bell Telephone Co.*, 292 U. S. 151, extended over a period of more than ten years and involved the collection from customers of many millions of dollars of excess charges which ultimately had to be refunded to them. See also *St. Joseph Stock Yards Co.* v. *United States*, 298 U. S. 38, 84, 88–92.

in sustaining an accounting order of the Interstate Commerce Commission, said:

> But, did we agree with appellant that the abandonments ought to be charged to surplus or to profit and loss, rather than to operating expenses, we still should not deem this a sufficient ground to declare that the Commission had abused its power.

Appellants, apparently recognizing the weakness of an attack upon the original cost provisions based simply upon the classification of investments which they enforce, make the further contention that, once the Commission has exercised the power reserved in paragraph (C) of account 100.4 to write off or to amortize amounts therein, the balance-sheet accounts will not show the company's total investment in telephone plant. In so far as the Commission directs amortization, its action is merely an application of the familiar accounting principle that there should be accruing charges to income or surplus to create a reserve sufficient to offset the property loss which ensues when property, whether tangible or intangible, outlives its usefulness and is no longer an asset of continuing value. With reference to possible write-offs directed by the Commission, it must be assumed in this preliminary attack upon the order before it has gone into operation, that write-offs will be directed only in those instances where the expenditure in question should not, under sound accounting principles, be capitalized as an asset. That

there are expenditures of this character is shown later. (*Infra,* pp. 32–38.) The writing off of such amounts has the effect of showing the company's actual investment in telephone plant, by eliminating what might otherwise be improperly included therein. Thus the Commission's order, so far from producing, as appellants contend, a distorted or untrue picture of the company's plant investment, in fact operates to prevent a distorted or misleading picture.

The Director of Research and Valuation for the New York State Public Service Commission expressed the opinion that if the information proposed to be shown by accounts 100.1, 100.2, 100.3 and 100.4 had been available to investors in public utility securities, the inflation in the prices of these securities during the 1920–1929 period, "based in many cases upon the publication of balance sheets showing investments in operating property far in excess of the original cost of such investments, would have been materially less than actually occurred, with resulting material decrease in the losses sustained by investors in the period since 1929." (R. 535.)

Under any accounting system the balances in the plant accounts at any given time are likely to correspond only approximately to the amount expended for plant. For example, under the 1933 System of Accounts, after exercise of the option to amortize, by debits to surplus, account 278, "Undistributed cost of property", and account 201,

"Organization", the balances in the plant accounts will not show the amount actually expended for plant.

3. ACCOUNT 100.4 IS NOT A SUSPENSE ACCOUNT

In the 1936 System of Accounts the balance-sheet accounts on the asset side are grouped under four headings: "Investments," "Current Assets," "Other Assets," "Prepaid Accounts and Deferred Charges." (R. 121.) The grouping in the 1933 System of Accounts was similar. (R. 376–377.)

The first group, as its designation "Investments" implies, consists of relatively permanent assets and the accounting rules are carefully framed to maintain this characteristic of the accounts included therein. For example, property in the telephone plant accounts is that "which ordinarily has a service life of more than 1 year" (Instruction 20 (A), R. 107) and account 101.2, "Advances to affiliated companies," which is in the "Investments" group, comprises advances which are to be funded or which are not subject to current cash settlement (Instruction 3 (M), R. 101). Not only does the classification of account 100.4 in the investment group indicate that it represents assets of a semi-permanent character, but it is given a sub-number under the main account number covering telephone plant. If the Commission had regarded this account as a suspense account or had intended others to so regard it, it would have been included in the

group of balance-sheet accounts designated "Prepaid Accounts and Deferred Charges."

Appellants, in contending that account 100.4 is a suspense account, treat the account as if items therein would permanently remain in the same contingent status as when they are first entered. It may be true that at that moment such items are subject to the contingency that the Commission will require them to be written off by a charge to surplus. But the statement in the accounting rules "shall be disposed of," etc., in accordance with the directions of the Commission presupposes that the Commission will make prompt disposition of these amounts. Once the Commission has acted as thus provided, amounts which it requires to be written off will be extinguished from the account and the balance remaining in the account will thereafter represent investment in assets of just as real and permanent a character as those represented by the other telephone plant balance-sheet accounts, 100.1, 100.2, and 100.3.

The basis for the preceding statement is as follows: Apart from writing off, the Commission may provide for amortization or it may provide for other disposition of amounts in 100.4. If it provides for amortization, it will direct that over a given period of time a charge be made to operating expense or to surplus and a corresponding credit to amortization reserve and that, at the end of such period, the sum of these charges be debited to amortization reserve and credited to account 100.4.

During this period the amount for which amortization is provided has as much the character of an investment asset as has property which is subject to depreciation charges.[9] The other kind of investment represented by 100.4, as, for example, excess value of land over and above original cost, will consist of amounts as to which the Commission has directed that they be retained in the account.

The supposititious balance-sheet set forth in the brief of additional appellants (p. 16) is based on testimony of one of appellants' witnesses that a balance sheet would be incomplete if it failed "to call specific attention on its face to the fact that the Commission must extinguish this item [account 100.4] and may extinguish it immediately." (R. 320.) As we have already shown, the statement that the Commission *may* extinguish the account is correct in the sense that at the moment amounts are first entered therein, some or all of them may be extinguished, but is substantially incorrect as applied to the status of the account after the Commission has given the directions which the accounting rules call for.[10] The statement that the Com-

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[9] Such property remains in the plant account at the original amount charged thereto until its retirement, when plant account is credited and depreciation reserve is debited.

[10] In the case of any balance sheet published before the Commission had so acted, if it would be sound accounting practice to append a note to account 100.4, the note could be so amplified as to guard against giving investors or others a misleading impression as to the character of the account.

mission *must* extinguish account 100.4 is based upon a misinterpretation of its order.

The Commission's chief accountant stated that the proper interpretation of account 100.4 was that amounts therein "would be disposed of, after the character of the item had been determined, in a manner consistent with the general rules underlying the uniform system of accounts for the distribution of expenditures, according to their character, to operating expenses, income, surplus, *or remain an investment.*" (R. 476.) Another accounting officer of the Commission declared that appellants' assumption that amounts in 100.4 must be extinguished is "unwarranted" and "fails to express the provisions of the Revised System of Accounts." (R. 518.) The acting director of the accounting department of the Wisconsin Public Service Commission, which had prescribed for electric utilities an account comparable to 100.4, expressed the opinion that, in view of the provision for subdividing this account according to the character of the amounts therein, amounts in 100.4 "might be *permanently retained in the investment accounts,* depreciated or amortized over the life of the property, or subject to such other disposition as might be appropriate." (R. 527.) He also said that after the Commission knows the facts it may then issue appropriate directions "for the *retention* or the disposal of the account in accordance with the principles set forth in the system of accounts." (R. 528.)

Appellants' argument that a reserve of surplus must be maintained against account 100.4 presupposes that the Commission will arbitrarily and improperly direct that *all* amounts in this account be written off, irrespective of their nature. This argument, as the District Court said, "requires the assumption that the Commission will act improperly in the future under 100.4 (*c*). This cannot be presumed." (R. 568.) If the Commission should in the future improperly order a write-off, the carrier could protect its rights by contesting the validity of this order in the courts.

Appellants stress the word "adjustment" in the title of account 100.4. But the inclusion of this account among those grouped as "Investments" and its exclusion from those grouped under the heading "Prepaid Accounts and Deferred Charges" removes any possible ambiguity arising from use of this word.

Appellants place great reliance upon *Matter of New York Edison Co.* v. *Maltbie*, 244 App. Div. 685, affirmed *per curiam* 271 N. Y. 103. The uniform system of accounts for electric corporations prescribed by the New York State Public Service Commission contained a definition of original cost similar to that in the 1936 System of Accounts and provided for entering amounts in account 143 on the same basis that amounts are entered in account 100.4. But account 143 differed radically from account 100.4. The former was a true sus-

pense account. Its title was "Suspense to be amortized." It appeared among the balance-sheet accounts under the heading "Deferred Debits", a group corresponding to those set forth under the heading "Prepaid Accounts and Deferred Charges" in the 1936 System of Accounts. There was entered in account 143 not only amounts equivalent to those entered in account 100.4, but also miscellaneous debit items subject to amortization by order of the Commission and losses from property retirements not provided for in the depreciation reserves.

Account 143 differed from account 100.4 in another important respect. Amounts in account 143 were to be "written off" over such period and in such manner as the Commission might prescribe; in other words, the account was to be written off in its entirety out of surplus. By way of contrast, the 1936 System of Accounts authorizes disposition of amounts in account 100.4 according to the character of the individual items—by an immediate write-off out of surplus, by amortization through debits to surplus over a period of years (*infra*, pp. 45–46), by amortization through charges to operating expense over a period of years (*id.*), by indefinite retention in this telephone plant investment account. This flexibility, the court below said, "distinguishes the system at bar from that held invalid in" the *New York Edison* case. (R. 568.)

While the Government does not assent to all of the reasoning of the New York Appellate Division, the holding itself, so far as it involves the original cost provisions of the order of the New York Commission, is clearly distinguishable.

4. THE PROVISION THAT THE COMMISSION MAY DIRECT THAT PART OF THE EXPENDITURE MADE TO ACQUIRE THE PROPERTY OF ANOTHER UTILITY BE WRITTEN OFF IS REASONABLE AND WITHIN THE COMMISSION'S STATUTORY AUTHORITY

Additional appellants appear to contend that account 100.4 (C) is void in so far as it authorizes the Commission to direct the writing off of amounts in this account. They assert in their brief (p. 14) that the Commission "has no power to require these appellants to write off and take as a loss a part of what they actually paid for their property." Since the Commission has not as yet directed the writing off of any amount, the contention necessarily is that the Commission is wholly without statutory authority to prescribe an accounting rule the effect of which is to deny the right to capitalize, under any and all circumstances, the entire amount expended in the acquisition of property of another utility. The contention is without merit unless such a rule is so utterly inconsistent with accepted accounting principles that it cannot be said to be an accounting rule which the statute authorizes the Commission to prescribe.

The Commission, when it prescribes a system of accounts, is not exercising its rate-making power

but, as shown later (*infra*, pp. 57–58), its power to prescribe accounts includes the power to establish accounts which will aid it in carrying out its other statutory duties, including that of prescribing reasonable rates and charges. We therefore submit that the Commission is authorized to prescribe accounts which accord with the principles enforced and applied in rate proceedings. Particularly is such action authorized if it serves to make effective another principle which this Court has recognized as within the power to prescribe accounts, namely, to make the accounts correspond with the substance of the transactions they record (*Kansas City Southern Ry. Co.* v. *United States*, 231 U. S. 423, 440, *infra*, p. 63).

There is no hard and fast, immutable line between expenditures which properly may be capitalized and those which may not. The extent to which it is proper to capitalize overhead expenses during construction is a frequent source of controversy and wide differences of view in rate proceedings. See *Los Angeles Gas & Elec. Corp.* v. *Railroad Commission*, 289 U. S. 287, 294, 310. The question of whether an expenditure may be capitalized or not is no different in principle from the question of when and under what circumstances an expenditure once capitalized should be extinguished from capital account. The latter was the principal issue presented in *Kansas City Southern Ry. Co.* v. *United States*, 231 U. S. 423. The price paid for

the purchase of property in transactions between controlled companies is no criterion as to what should be entered into the capital account of the purchasing company. (R. 536.) Where buyer and seller are under common control, part of the purchase price for equipment may be excluded from the purchaser's property account in a rate proceeding. *Lindheimer* v. *Illinois Bell Telephone Co.*, 292 U. S. 151, 157.

It must also be borne in mind that even when the transaction is between independent companies the amount paid to acquire going telephone property may frequently be in excess of every element of value inherent in the property, including going-concern and good-will value. Since the modern telephone system, if it is to function efficiently, must be closely coordinated and unified with respect to both physical facilities and operating policies, an independent concern may have a very substantial "nuisance" value enabling it to command a price in excess of actual value.

Tri-State Telephone & Telegraph Co. Proposed Control, 180 I. C. C. 229, illustrates this nuisance value. The Tri-State owned the telephone exchanges in St. Paul and a Bell company those in Minneapolis. From a plant and engineering standpoint the two telephone properties constituted one telephone exchange area and the same operating practices had to be observed in both cities if delays, inefficiency and undue cost were to

be avoided. The two companies had been only partially successful in satisfactorily coordinating service, and the difficulties in doing this were increasing and promised to become much more serious. The Bell company believed that independent operation of the St. Paul exchange constituted a serious hazard to its Minneapolis investment. Accordingly, it agreed to buy substantially all the Tri-State stock for $19,510,101. This price was more than double the appraised value of the assets represented by the stock, excluding organization expenses and going value, and more than 150% of such value if these intangibles were included. The difference between price and value was so great that the Commission refused to issue a certificate that the acquisition would be in the public interest.[11]

If the foregoing transaction had been carried out and the Bell Company had then taken over the Tri-State property, the cost thereof would have been the amount paid for the stock, or over 50% more than every element of value attaching to the assets acquired, including intangibles. Under the 1933 System of Accounts this excess would go into

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[11] Within fifteen months of this decision an agreement was reached for the sale to the Bell Company of the Tri-State stock for approximately $7,000,000 less than the price previously agreed upon and the Commission thereupon issued a certificate of public interest under Section 5 (9) of the Interstate Commerce Act. *Tri-State Telephone & Telegraph Co. Control*, 193 I. C. C. 383.

account 278, and therefore into the balance-sheet account representing telephone plant, unless the company *voluntarily* amortized all or a part of the excess by debiting surplus. An accounting system which permits this kind of an inflation of the telephone plant account impairs its integrity. We do not contend that payments in excess of value for going telephone concerns or their property may not be justified from a business standpoint, but that the excess payment should be charged against past or future profit and loss, either by an immediate debit to surplus or by amortization chargeable to surplus over a period of time. Furthermore, such charges should not be left to the discretion of the accounting company, but should be subject to the control of the regulatory body whose duty it is to prescribe uniform accounts and to see that they are carried out in accordance with their intended purpose and effect.

Acquisition of Control of Northwestern Long Distance Telephone Co., 71 I. C. C. 530, is another instance where the purchase price was largely dictated by nuisance value. A Bell company agreed to pay $545,000 for the property of a company operating toll lines between exchanges all of which were reached by the Bell company's toll lines. The latter's facilities were ample to handle the business of both companies for years to come. The value to the purchaser of the property to be acquired was

therefore only its junk or salvage value, as the Commission recognized by stating that the investment could be amortized in a few years' time out of the additional revenues to be obtained from business formerly handled by the competitor.

An accounting system which provides that a company may, whatever the circumstances, record its telephone plant on its balance sheet in terms of the money, plus the value of any consideration other than money,[12] exchanged for telephone plant, conceals data which is truly informing and supplies that which is likely to be misleading. *Acquisition of Illinois Southern Telephone Co.*, 145 I. C. C. 43, illustrates this situation. A new company was to be formed to buy all the assets of four existing telephone companies (the stockholders of which were identical), giving in exchange therefor cash (derived from sale to the public of certain amounts of its bonds and preferred stock) and 40,000 shares of its common stock. In substance, therefore, there was a mere recapitalization involving no change in beneficial ownership, but "cost" to the new company was the cash which it had paid out and the value attributable to its common stock. The almost untrammeled latitude afforded the company's officers and accountants in determining *ex parte* such

[12] See Instruction 20 (B) of the 1933 System of Accounts (R. 365) and account 100.4, par (A), of the 1936 System of Accounts (R. 123).

common stock value is obvious [13] and the opportunity afforded to mislead investors is equally obvious. Although the Interstate Commerce Commission refused to issue a certificate of public interest, upon the ground that the proposed financing "would increase largely the securities outstanding in the hands of the public without the addition of any property", the transaction was carried out under approval given by the Illinois Commerce Commission (H. Rept. No. 1273, 73d Cong., 2d Sess., p. XIX).[14]

Possibly appellants will urge that public regulation of acquisitions of telephone property is adequate to guard against abuse and that therefore no good reason exists for the adoption of an accounting rule which permits the Commission to direct the writing off of part of the consideration given for telephone property acquired from another utility. There are a number of grounds why such a contention must be rejected.

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[13] The Illinois Commerce Commission, in approving the acquisition, apparently made no independent examination of the property appraisals which were submitted to it and apparently assumed that the no-par common stock would be capitalized at the minimum of $5 a share required by Illinois law. (145 I. C. C. 43, 45.) Actually, the new company capitalized its common stock at eight times this amount, $40 a share. (Poor's Public Utilities Manual, 1929, p. 1300.)

[14] The company making the acquisition is not an appellant, but it is controlled by the same holding company as the additional appellants. (Moody's Public Utilities Manual, 1935, p. 510.)

The question of possible state regulation may be summarily put aside. The Federal Government is not constrained to withhold exercise of its constitutional powers because the individual states may step into the breach if it does not act. The very purpose of Federal control within the interstate commerce field is to achieve uniformity in regulation, which cannot be achieved under the varying regulatory provisions (or none at all) of the laws of the several states.

Such regulatory powers as are or have been vested in the federal Government are inadequate to meet the purposes of the accounting provision in question. Section 221 (a) of the Communications Act, *infra,* p. 72, and the preceding Section 5 (18) of the Interstate Commerce Act, which relate to consolidations of property of two companies and acquisitions of stock or leasehold control, do not *require* federal approval of these transactions; they merely provide that any federal law making the transaction unlawful shall not apply to a transaction approved thereunder. Section 214 (a) of the Communications Act, *infra,* p. 72, makes it unlawful to acquire or operate a telephone "line" without a certificate from the Commission, but there was no similar provision applicable to telephone companies in the Interstate Commerce Act. (Compare Sec. (1) 18 of that Act.) Accordingly, in the case of property acquisitions prior to the summer of 1934, there was no necessity for obtain-

ing federal approval unless the acquisition might otherwise fall within the prohibitions of the federal antitrust laws. But apart from this consideration, there is no reason why such regulatory control as these statutory provisions authorize should not be supplemented by an appropriate exercise of the Commission's power to regulate accounts. The disparity between price and the value of the property acquired need not be so great so as to make the transaction not in the public interest, even though the price might be in excess of every element of value which it would be proper to carry in capital account as a continuing asset.

5. PARAGRAPH (C) OF ACCOUNT 100.4 IS NOT INVALID BY REASON OF THE FACT THAT IT DOES NOT ITSELF LAY DOWN THE RULES BY WHICH THE COMMISSION WILL ACT IN DIRECTING THE WRITING OFF, OTHER DISPOSITION, OR AMORTIZATION OF AMOUNTS IN THIS ACCOUNT.

Paragraph (C) of account 100.4 provides that amounts in this account shall be written off, disposed of, or amortized according to the directions of the Commission. Apart from the contention already considered that this operates to make account 100.4 a suspense account, appellants attack this provision (Br., pp. 27–31), not on unconstitutional grounds, but on the ground that it is beyond the Commission's statutory authority. The contentions seem to be (1) that when an accounting regulation fails to state specifically the rule or rules in accordance with which amounts entered

therein shall be ultimately disposed of, it does not constitute an accounting rule of the kind contemplated by the statute and (2) that the authority given the Commission to prescribe a system of accounts does not include the authority to reserve to itself power of control over the disposition of particular items. The two contentions are so interrelated that no attempt will be made to consider them separately.

There is no doubt that account 100.4 clearly specifies the accounting requirements which it imposes. Paragraph (A) sets forth the exact method whereby amounts to be entered in the account shall be determined. Paragraph (B) requires a subdivision of these amounts according to their character. Paragraph (C) provides that the company shall follow the directions given by the Commission as to the subsequent disposition of amounts recorded in the account. A rule which leaves the accounting company in no doubt as to what entries it should make in its books of accounts would seem to constitute a valid exercise of the authority given by the Act to prescribe the forms of accounts and records to be kept by carriers subject to the Act.

Appellants do not assert that the Commission is without authority to exercise regulatory power with respect to accounting for particular items or transactions. Any such contention would be plainly erroneous; no system of accounts can be framed in such detail that it can be applied with-

out further intervention or interpretation by the regulatory body.[15] Such a contention would also be directly inconsistent with the power exercised by the Interstate Commerce Commission over a long period of time, under identical statutory authority, to direct the accounting entries to be made in recording a particular transaction or particular property, an exercise of power which has received the approval of this Court. *Norfolk & Western Ry. Co.* v. *United States,* 287 U. S. 134. See also *Atlanta, Birmingham & Coast R. R. Co.* v. *United States,* 296 U. S. 33; *Chesapeake & Ohio Ry. Co.* v. *United States,* 5 F. Supp. 7; *Accounting of New York Telephone Co.,* 188 I. C. C. 83; *Acquisition of Property by Saratoga & Encampment Valley R. R. Co.,* 192 I. C. C. 719.

Since, therefore, the statute gives the Commission some authority to direct the disposition of particular items, the question here presented concerns the possible limits of this authority. Are those limits transcended if the Commission, as to the class of transactions which come within account 100.4, fails to announce in advance the rules in accordance with which it will direct disposition of

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[15] In Accounting Bulletin No. 11, issued June 26, 1916, effective July 1, 1916, the Interstate Commerce Commission embodied the more important rulings and interpretations which it had made in administering the uniform system of accounts for telephone companies, effective January 1, 1913. The Bulletin consists of 176 "Cases" set forth in the form of "Query" and "Answer".

amounts in this account? We submit that the answer to this question depends upon whether or not, under all the circumstances affecting proper accounting for the class of transactions in question, the failure to lay down advance rules is manifestly without reasonable justification. If this is so, the situation under consideration is altogether different from that which appellants suggest (Br., p. 29) as analogous, namely, "an order merely providing that all entries shall be made as the Commission, in its discretion, may direct".

In view of the multitude of factors affecting proper accounting for amounts in account 100.4, a rule which attempted to specify in advance in what manner each such amount should ultimately be recorded would seem so likely to prove inequitable and unduly rigid in practice that the rule would be far more open to the charge that it was arbitrary than one which reserves to the regulatory body necessary flexibility in dealing by appropriate proceedings with the facts and circumstances presented in individual cases as they arise.

In the accounts for electric utilities prescribed by the Wisconsin Public Service Commission there is an account termed "Fixed Capital Purchase Adjustment" comparable to account 100.4. The acting director of the Department of Accounts and Finance of that Commission stated that he had found that the nature of the items entering into this comparable account differed according to the

facts in individual cases, and that under such conditions it was "practically impossible to make a uniform rule with respect to the disposition of amounts" in such an account. (R. 528.) He added that, when the facts were known, appropriate directions might then be issued "for the retention or the disposal of the account in accordance with the principles set forth in the system of accounts". Another Commission witness stated that the reservation of power to deal with individual property acquisitions was "necessary in order that limitations may not prevent proper regulation". (R. 490.)

Moreover, it cannot be assumed that the Commission, in acting under paragraph (C), is without standard or guide. The entire body of accounting rules furnishes the controlling principles in accordance with which it will exercise its authority. The situation is not dissimilar to that considered in *New York Central Securities Co.* v. *United States,* 287 U. S. 12, 24, where the carrier urged that authority given the Interstate Commerce Commission to approve acquisitions of control which it found to be in the "public interest" was an unconstitutional delegation of legislative power because the statute furnished no standard to guide determination of this question. This Court said that a sufficient standard was to be derived from the "purpose of the Act, the requirements it imposes, and the context of the provision in question". In like man-

ner, the purpose of the system of accounts adopted by the Communications Commission, the requirements which the system imposes, and the context of paragraph (C), together with the general principles of correct accounting, supply a standard by which the Commission may determine the directions it should give as to the writing off, amortization, or other disposition of amounts in 100.4.

6. SINCE THE COMMISSION'S ORDER PERMITS AMORTIZATION CHARGEABLE AS AN OPERATING EXPENSE OF AMOUNTS IN ACCOUNT 100.4, IT PROTECTS ANY SUBSTANTIVE RIGHT WHICH APPELLANTS MAY HAVE TO CHARGE DEPRECIATION AGAINST AMOUNTS IN THIS ACCOUNT.

Appellants contend that the Commission's order is arbitrary because it does not permit depreciation charges against amounts included in account 100.4. The account is to be subdivided according to the character of the items which it contains and the Commission may direct that provision be made for amortization of amounts in this account. The Commission may therefore provide for amortization of such amounts in the account as may be properly classified as investment in depreciable property. This depreciable property investment would appropriately be subdivided upon the basis of the classifications in the primary plant accounts and amortization might be provided on a basis equivalent to the depreciation rate applicable to the particular property classification.

The Commission's order provides for amortization chargeable as an operating expense (account 613, R. 186) and amortization by debits to surplus (account 413, R. 167). Both classes of amortization charges are credited to amortization reserve (account 172, R. 140), which specifically provides that it shall also be credited with any amounts resulting from amortization of balances in account 100.4. Both of the accounting officers of the Commission whose affidavits were received in evidence stated that paragraph (C) permitted amortization chargeable as an operating expense. (R. 476, 512, 517, 520.) Another Commission witness expressed the same view (R. 537) and the District Court (R. 568) likewise adopted this interpretation. We therefore submit that the evidence establishes that the Commission's order permits amortization of amounts in 100.4 through a charge to operating expense. If, however, there were uncertainty as to the correctness of this construction and if a contrary construction might appear to infringe appellants' constitutional rights, the uncertainty is removed by application of the familiar rule that in interpreting statutory provisions or administrative regulations, if two constructions are possible, one of which would give rise to serious constitutional doubts and one of which avoids such doubts, the latter construction will be adopted. *Addy Co.* v. *United States,* 264 U. S. 239, 245.

The fact that the Commission might possibly apply its order in an unconstitutional manner does

not, in advance of such improper application, deprive appellants of property without due process. Nor are they deprived of any substantive right if, by means of amortization, provision may be made for the building up of a reserve, through charges to operating expense, which will protect their property investment.

The District Court rejected the contention that the failure to allow depreciation as such against amounts in 100.4 made the original cost provisions arbitrary, saying (R. 568–569):

> This complaint anticipates arbitrary action by the Commission, under 100.4 (c) which authorizes handling of this item through amortization. The effect would be the same as writing down through depreciation, and until the Commission acts so that the accounts become so contrary to the principles of correct accounting as to constitute the Commission's order arbitrary and unreasonable, the Commission is within its powers.

What is essential from the standpoint of the principles of sound accounting in the matter of depreciation is that some provision be made for an annual charge to income which will build up a reserve against which may ultimately be charged the loss ensuing when the serviceable life of depreciable property has expired and the property is scrapped. Whatever basis is used for determining this annual charge, whether replacement cost at time of acquisition or original cost or current value from year to year (cf. *United Railways* v.

West, 280 U. S. 234), there is not, and in the nature of the case there never can be, any assurance that the reserve accumulated will exactly correspond to the cost of replacing the property at the particular time when it reaches the end of its useful life.[16] As Commissioner Eastman observed in *Telephone and Railroad Depreciation Charges,* 177 I. C. C. 351, 381, "Accounting is not an exact science." We submit that there is no violation of the constitutional guarantee of due process if, in the case of property placed in public service by another utility and subsequently acquired from it, depreciation charges as such are calculated on the basis of the original cost of the property to the company first placing it in public service.

In practically every such acquisition, what is acquired is not specific pieces of depreciable property but rather a going plant or business for which a lump sum is paid. This lump sum is obviously measured by the value of the going plant or business as a whole. It therefore practically never corresponds to the value of the specific items of depreciable property acquired, on whatever basis they are valued. The value or cost to the purchaser of the depreciable property acquired is merged or lost in the total price paid for the acquired business as a whole. The problem is there-

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[16] See *Knoxville* v. *Knoxville Water Co.*, 212 U. S. 1, 13–14, where it was said that the purpose of depreciation charges was to make provision from earnings for replacing the property at the end of its life.

fore presented as to what method shall be employed for setting up the cost of the individual units of depreciable property on the books of the purchaser as a basis for annual depreciation charges.

One possible method is that provided by the 1933 System of Accounts, namely, to enter the depreciable property on the books of the purchaser at the estimated replacement cost of each item at the date of the acquisition and to base depreciation on these figures. This is essentially artificial because it rests on the fiction that what was purchased at the time of the acquisition was the specific items of property at the price for each item then prevailing in the market, whereas in reality what was purchased was a going business as a whole without specific regard for the particular units of property. This method of accounting is also open to the practical objection that it affords opportunity for improper inflation of depreciation charges, since there can be no adequate administrative check upon appraisals of replacement cost at excessively high figures. Another possible method, that adopted in the 1936 System of Accounts, is to record the individual units of property at their cost when first devoted to the public service, i. e., at the same figures which served as the basis for depreciating those items when they were in the hands of the former owner. This means that each such item of property will continue to be depreciated after the acquisition on the same basis as before without permitting the sale of the business

as a whole to alter the basis of depreciation of the specific items of depreciable property.

We submit that there is no violation of any constitutional right in requiring the use of the latter method of calculating depreciation for accounting purposes instead of the former. Appellants seem to contend that depreciation must be based on cost to the owner in whose hands the property is being depreciated and that, where property already in public service is acquired by a subsequent owner, the cost to the latter is replacement cost at the moment of the acquisition. Irrespective of the validity of this contention as applied to the purchase of specific items of property as such, it clearly has no application where the property transferred is part of a going business for which a lump sum is paid, since it is purely artificial to say that the specific items of property are included in the lump sum price at the figures which represent the respective replacement costs of these individual items in the open market.

Irrespective of whether depreciable property is set up on the books and depreciated on the basis of its original cost or on the basis of its artificial replacement cost at the actual moment of transfer as part of a going business, the real and substantial question is this: What disposition shall be made of the difference between such original cost or replacement cost, on the one hand, and the lump-sum acquisition cost of the business as a whole, on the

other hand? This problem exists whichever basis is adopted for recording the depreciable items. Under the 1933 System of Accounts, this difference goes into account 278, where it remains as a permanent asset item unless the accounting company voluntarily amortizes it by debiting surplus. Under the 1936 System of Accounts, the difference goes into account 100.4 and, as already shown, such part of the difference as should properly be amortized by charging operating expenses may be so amortized. For example, if in a particular case a part of the excess of the lump sum paid for the business as a whole seems fairly attributable to the fact that there has been a rise in the open-market price of some or all of depreciable items of property of the kind included in the purchase, then it would obviously be appropriate to amortize such part of the excess out of current operating expenses. On the other hand, such part of the excess as appears to be attributable to the business advantage of acquiring a going concern at somewhat more than its individual assets are actually worth may appropriately be amortized by debiting surplus. It may well be that this method of dealing with the sums in question may be considered as not ideally the best method, but we submit that it is a method within the bounds of reasonableness and therefore not so inherently arbitrary as to violate the constitutional guarantee of the Fifth Amendment.

Additional appellants contend (Br., pp. 20–22) that the failure to make specific provision for de-

preciation on amounts in account 100.4 is in conflict with the requirements of Section 220 (b) of the Act, *supra,* pp. 4–5. That section provides that the Commission shall, as soon as practicable, prescribe the "classes of property" for which depreciation charges may be included under operating expenses. The section, except for immaterial changes in verbiage, is the same as language added to Section 20 (5) of the Interstate Commerce Act by Section 435 of the Transportation Act, 1920 (41 Stat. 493). As pointed out in *Telephone and Railroad Depreciation Charges,* 177 I. C. C. 351, 360–369, this amendment was not in derogation of, but in confirmation of, the general powers over accounts previously vested in the Interstate Commerce Commission (in language identical with Section 220 (a) of the Communications Act), and the major purpose of the amendment was to bring about a fuller exercise of existing power with reference to depreciation charges.

There are two possible interpretations of Section 220 (b), neither of which aids appellants. If prescribing the "classes of property" on which depreciation may be charged embraces the power (1) to determine the classes of property which are depreciable and (2) to determine the base on which depreciation shall be computed as to property classified as depreciable, the Commission's order constitutes an exercise of both these powers and is therefore not in conflict with Section 220 (b).

There is no implication in the language of the section that the Commission, if it lays down rules as to the depreciation base, must establish the same base for all property of the same class, irrespective of the manner of its acquisition. If, however, the authorization in Section 220 (b) is interpreted as confined to classifying property according to whether it is or is not depreciable, then determination of the depreciation base—a necessary incident to the power to prescribe rules covering depreciation charges—flows from the Commission's general power over accounts and is not affected by or in conflict with Section 220 (b).

7. THE ORIGINAL COST PROVISIONS ARE NOT INVALID BY REASON OF THE COST OF COMPLIANCE.

A regulation validly imposed in the exercise of public regulatory authority is not rendered invalid because compliance therewith will subject the utility to additional expense. Cost of compliance is not even relevant to the question of validity unless, possibly, when such cost is shown to be entirely disproportionate to any public benefit which may reasonably follow from the regulation. Whether the public benefit justifies the cost of compliance presents a problem calling for the exercise of administrative judgment and where such a question is presented the courts decline to substitute their judgment for that of the body charged with execution of the law.

We submit also that appellants have not shown that the original cost provisions are unduly burdensome. They refer to the estimate that the cost to the Bell companies of putting these provisions into effect would be "several millions of dollars." (R. 341.) The only estimate which was based upon a detailed study of the work involved is to the effect that the cost to the New York Telephone Company would be $432,100. (R. 332.) Since the *net* operating income of this company was over $32,000,000 in 1935 (Moody's Public Utilities Manual 1936, p. 182), this cost would be only a little over 1% of such income. Moreover, this is not an annual, recurring cost. Once the property now held is restated on the basis of original cost, accounting for future acquisitions from utilities would probably be less costly than at present because, except as to the few companies not subject to the Commission's order, the vendor's books will show original cost and the purchaser will take over the property at these book amounts.

There is no reason to suppose that the Commission will be unduly exacting in the identification of property subject to restatement on the basis of original cost. Its order provides that in accounting for retirement of telephone plant, "average" original cost shall be used in determining the original cost of the items retired when "it is impracticable to determine the original cost of each item due to the relatively large number

or small cost of such items." (Instruction 25 (D), R. 114.) The Commission may be expected to permit the use, in appropriate cases, of the same principle of averaging for determining to what extent property previously acquired from other utilities is still in existence.

Congress has authorized the Commission to require telephone companies to file with it a statment showing original cost of their property. (Sec. 213 (c).) The grant of this authority amounts to a legislative determination that to require the furnishing of this information is not unreasonably burdensome.

III

THE PROVISION THAT THE CHARGES TO CERTAIN ACCOUNTS SHALL BE JUST AND REASONABLE AND THAT PAYMENTS IN EXCESS THEREOF SHALL BE CHARGED AS A NON-OPERATING EXPENSE IS NOT ARBITRARY OR UNREASONABLE

Instruction 2 (B. 1) provides (R. 98):

> All charges to the accounts prescribed in this classification for telephone plant, income, operating revenues, and operating expenses shall be just and reasonable and any payments by the company in excess of such just and reasonable charges shall be included in account 323, "Miscellaneous income charges".

We subscribe to appellants' statement (Br., p. 37) that net operating income is "one of the most

vital items in the companies' statements, of wide interest to investors and others". 'But their further statement: "Whether an outlay of an operating expense was reasonable or unreasonable, being paid and non-recoverable, it nevertheless is an outlay which should enter into the computation of net operating income," rests upon the untenable proposition that any amount, however unreasonable, which a controlling company exacts in payment for services or property should be charged in full to operating expense. In such circumstances the excess payment is not a true expense of operation or a true item of cost of property, but is special tribute levied by reason of corporate control. If this tribute is accounted for as operating expense or is added to telephone plant account (thereby increasing depreciation charges, an operating expense), the statement of net operating income on the books of account is falsified by the inclusion therein of items which ought to be a charge against non-operating income. (R. 513.)

All but a small fraction of the country's telephone business is performed by holding company systems so that amounts paid for telephone plant and for services chargeable to operating expense are "in a large part paid to affiliated companies and are not results of arms-length transactions". (R. 539.) In rate litigation, charges for services and for property, in transactions between companies in the same system, are recognized, in the com-

putation of operating income and of property devoted to the public service, only to the extent that the charges are reasonable. *Smith* v. *Illinois Bell Telephone Co.*, 282 U. S. 133; *Lindheimer* v. *Illinois Bell Telephone Co.*, 292 U. S. 151; *Dayton Power & Light Co.* v. *Public Utilities Commission*, 292 U. S. 290; *Columbus Gas & Fuel Co.* v. *Public Utilities Commission*, 292 U. S. 398. In the litigation before the Court in the two telephone cases it was found that the average annual overpayments to the parent company for services during a five-year period had amounted to $545,443 and that equipment had been purchased from a subsidiary of the same parent at prices in excess of what was reasonable. (292 U. S. 151, 157, 165.)

One of the duties of the Communications Commission is to prescribe just and reasonable charges for telephone companies. (Sec. 205.) It is also specifically authorized to examine into transactions which relate to the furnishing of equipment supplies, research, services, finances, etc., which may affect carriers' charges for the services which they render. (Sec. 215 (a).) In *Norfolk & Western Ry. Co.* v. *United States*, 287 U. S. 134, the carrier, in challenging an order which required it to classify certain coal mines as non-transportation property, contended (pp. 138–139) that the general discretion given the Interstate Commerce Commission to prescribe a uniform system of accounts was limited by the purposes and ends for which such

accounts are to be kept, as exhibited in other sections of the Act. This Court adopted this as a proper test to apply and one of the grounds (pp. 140–141) upon which it affirmed the Commission's order was that two other sections of the Act "draw the very distinction" between transportation and non-transportation property which the accounting rule in question had long enforced.

In *Kansas City Southern Ry. Co.* v. *United States,* 231 U. S. 423, the Court gave as a reason for sustaining an accounting order, that it would aid the Commission in the performance of other of its statutory duties. The Court said (p. 445):

> Since the regulation of the railroad carrier by the public authority, and especially the fixing of the rates to be charged, depend primarily upon two fundamental considerations, (a) the value of the property that is employed in the public service, and (b) the current cost of carrying on that service, it is clear that the maintenance of a proper line of distinction between property accounts and operating accounts is essential to the execution by the Interstate Commerce Commission of the supervisory and regulatory powers conferred upon it by Congress.

See also *Interstate Commerce Commission* v. *Goodrich Transit Co.,* 224 U. S. 194, 211, 213–214, 216.

Since the power to prescribe uniform accounts "includes the power to inquire into expenditures and their proper assignment in the accounts" and

"power to prevent evasion * * * and detect in any formal compliance or in the assignment of expenses a 'possible concealment of forbidden practices'" (*Smith* v. *Interstate Commerce Commission*, 245 U. S. 33, 43, 45), the power clearly exists to prescribe accounting rules designed to prevent evasion before the event rather than after. This is the purpose and effect of the provision as to just and reasonable charges. It enables the Commission to perform in a practicable manner the duty resting on it to see that accounts subject to its jurisdiction truly reflect the transactions which they purport to record. Without this power, the burden of determining whether entries recording transactions between affiliated companies represent a true statement of operating income, operating expense or telephone plant account "would be such as to destroy all effective regulation"; each and every such entry would have to be audited by the Commission "before any credence whatsoever could be attached to it." (R. 539.)

The regulation in question is therefore justified on two grounds, first, as an aid in the performance of other duties which the statute imposes upon the Commission and, second, as a reasonable means for making effective a cardinal principle of any accounting system promulgated by a regulatory body, that the accounts shall faithfully represent the substance of the transactions which they record (*infra*, p. 63).

Appellants assert (Br. p. 37) that the statute makes failure to comply with an accounting order of the Commission a penal offense and assert (Br., p. 38) that the obvious purpose of the accounting rule as to just and reasonable charges "is to allow the Commission, through fear of criminal prosecution, to impose its judgment on the company as to the reasonableness of every outlay".

Appellants do not specify the penal provisions to which they refer. Section 220 (e), *supra*, pp. 5–6, and Sections 501 and 502, *infra*, pp. 73–74, which sections contain the only penal provisions which might be applicable, are limited to acts done "wilfully and knowingly" or "wilfully". It is clear that, in the absence of actual bad faith, an entry of a charge in excess of an amount which was subsequently determined to be just and reasonable would not be the wilful or knowing violation condemned by these sections. In addition, Section 220 (d), *supra*, p. 5, provides a forfeiture, which under Section 504, *infra*, p. 74, is recoverable in a civil suit, if a carrier fails or refuses to keep such accounts as the Commission shall prescribe and in the manner prescribed by it. In any proceeding under this section the defendant would be free to make the defense, if it is a valid one, that "just and reasonable" is not a sufficiently definite standard to support a money forfeiture.

The provisions of Section 220 (d) are almost identical with those of Section 20 (6) of the Interstate Commerce Act. Although the latter section

has been in effect since 1906 (Act of June 29, 1906, 34 Stat. 594), the only reported case under this section, *United States* v. *Clyde S. S. Co.*, 36 F. (2d) 691, certiorari denied 281 U. S. 744, was a proceeding, not for failure to keep accounts as prescribed, but for refusal to permit the Commission to inspect accounts and records.

The Interstate Commerce Commission endeavors to adjust infractions of its accounting rules through correspondence or conference and, if necessary, issues a report, but usually not an order, indicating the correction to be made. *United States* v. *Atlanta, Birmingham & Coast R. R. Co.*, 282 U. S. 522. If the carrier still resists, the Commission issues an order, the legality of which may be tested in a suit to set it aside. *Norfolk & Western Ry. Co.* v. *United States, supra; Atlanta, Birmingham & Coast R. R. Co.* v. *United States*, 296 U. S. 33. We submit that it is improper to assume that the Communications Commission will proceed in any less reasonable or orderly manner, or that the forfeitures authorized by Section 220 (d) will operate to coerce appellants into submission to the will of the Commission.

The requirement that the charges to certain accounts shall be just and reasonable materially affects only a very limited class of transactions. Typical of these are contracts under which a holding company furnishes services to subsidiaries or under which one company supplies equipment to

another, both being under common control. Since the terms of such contracts are usually uniform for all affiliated companies, the reasonableness of the charges thereunder can be readily removed from the area of doubt by presenting the matter to the Commission pursuant to Instruction 9 (R. 104). After it issues its directions or order, the contents of the words "just and reasonable" and the obligation of the company with respect thereto are precise and definite. As was said of a tax which was attacked as failing to define the scope of the obligation, but which might be clarified by administrative action, "The demands of due process are satisfied if reasonably clear definition is afforded in time to give the taxpayer an opportunity to comply." *Pacific Tel. & Tel. Co.* v. *Seattle,* 291 U. S. 300, 304.

We also submit that the words "just and reasonable" furnish an adequate guide to the obligations which the requirement in question imposes. The District Court pertinently observed (R. 571) that the cases such as *United States* v. *Cohen Grocery Co.,* 255 U. S. 81, upon which appellants rely, are distinguishable because the statutory provisions there held to be too vague or indefinite were "without the specialized content of the word 'reasonable' with regard to charges involved in the determination of rates." (R. 571.) The words "just and reasonable" or their opposite "unjust and unreasonable" are repeatedly used in defining obligations imposed by the Interstate Commerce

Act. See Sections 1 (5), 1 (6), 1 (11), 1 (12), 15 (1), 15 (2), 15 (6), 15 (7).

The requirement that the charges to certain accounts shall be just and reasonable does not give the Commission the power to "require recording what the Commission may think should have been done, instead of what actually occurred." (App. Br., p. 38.) The real question at issue is whether form rather than substance shall determine what "actually occurred" and whether the company shall be the final arbiter of this question.

Insistence that accounts shall correspond to the substance of the transactions which they record does not amount to giving the Commission power to interfere in management. In *Kansas City Southern Railway Co.* v. *United States,* 231 U. S. 423, 440, the carrier argued that the authority to prescribe uniform accounts was confined to regulation of their form and that regulation which dealt with substance, that is, with the accounting required in particular circumstances, would constitute unauthorized interference with management. This Court said (pp. 440–441):

> The very object of a system of accounts is to display the pertinent financial operations of the company, and throw light upon its present condition. If they are to truly do this, the form must correspond with the substance. * * * There is no direct interference with the internal affairs of the corporation; and if such interference indirectly

> results, it is only such as is incidental to the lawful control of the carrier by the Federal authority * * *.

See also *Norfolk & Western Ry. Co.* v. *United States,* 287 U. S. 134, 143; *Interstate Commerce Commission* v. *Goodrich Transit Co.,* 224 U. S. 194, 211.

IV

THE PROVISIONS GOVERNING CLASSIFICATION OF PHYSICAL PROPERTY ARE NOT ARBITRARY OR UNREASONABLE

One of appellants' grounds of attack is that the distinction between accounts 100.1 and 100.3 is so indefinite as to be arbitrary. Account 100.1 embraces the property "used in telephone service" and account 100.3 is designated as "Property held for future telephone use." (R. 123.) The alleged ambiguity concerns the word "used" in account 100.1 in its relation to "spare" plant, that is, subsidiary parts of a larger unit, such as a cable, switchboard, underground duct, etc. which may be temporarily not in use (R. 342, 556). We submit that whatever ambiguity, if any, once existed, has been dispelled by the evidence presented in this case. Each of the Commission's witnesses (except one, who failed to state his interpretation), including the Commission's chief accountant and its chief accountant in a telephone investigation undertaken pursuant to a Senate Resolution, definitely interpreted account 100.1 as including such spare plant.

(R. 482, 509, 529, 538, 549.) The District Court likewise made a finding to this effect. (Fg. XVI, R. 577.)

The point stressed by the Commission's witnesses was that property is used in service, although subsidiary parts thereof are not being used to full capacity and that the Commission's order does not require any segregation between an operating unit of property and its component parts. Appellants (Br., p. 46) refer to the testimony of the Commission's chief accountant that account 100.1 would include "necessary spare plant" (R. 482), but this witness placed no special emphasis upon the word "necessary." Moreover, he stated that periodical transfers between account 100.1 and account 100.3 "will not be required by reason of seasonable changes or fluctuating demands for plaintiffs' services." (R. 482.)

Appellants suffer no substantial injury by reason of the alleged ambiguity. The Commission's order, as modified by the decree, allows depreciation charges against property in account 100.3. (R. 585.)

Appellants' other attack upon the classification of physical property is that the distinction between accounts 100.3 and 103 is so vague as to be arbitrary. Both the 1933 and 1936 Systems of Accounts distinguish between operating and non-operating property. In the former system, account 100 includes property used in telephone service or "held under a definite plan" for such service

and account 103 includes all physical property not covered by account 100. (R. 378–379.) In the latter system, there are four balance-sheet telephone plant accounts, but only account 100.3, which applies to property "held for imminent use in telephone service under a definite plan for such use", is here material. (R. 123.) Account 103 includes all physical property not included in the balance-sheet telephone plant accounts. Under both systems, therefore, property which is not in use or under construction is not included in telephone plant unless it is held under a "definite plan" for use in telephone service. The 1936 System of Accounts adds the additional qualification that the property be held for "imminent" use in such service.

The 1933 system seems defective in classifying property as operating property merely because it is held under a definite plan for telephone service. It is highly commendable to plan for future needs, but all property acquired under such a plan, even though the plan is definite, is not operating property, whether the test be what would popularly be regarded as such or what would be included in the rate base in a rate proceeding. Whether the Commission, in undertaking to narrow the earlier definition, made the wisest possible choice of terms in adding the requirement as to "imminent" use is immaterial. Appellants have no constitutional right to a particular degree of definiteness of meaning in the terms employed to define the contents

of an account. The words "definite plan" are not without elements of ambiguity. The word "imminent" will acquire precision through interpretation by the Commission. Unless it is improperly assumed that the Commission will be wayward or inconsistent in its interpretations (see App. Br., p. 43), just as great a degree of uniformity will ensue under these interpretations as if the concept had been elaborated and expanded in the account itself.

This Court has used the word "imminent" in defining the line between property which may be included in the rate base and that which may not. *Columbus Gas & Fuel Co.* v. *Public Utilities Commission,* 292 U. S. 398. A company which was selling natural gas to an affiliated company obtained its supply from tracts of land held under lease. It also held leases on other tracts, some proven and some not proven, which were not in production but which represented a source of future supply when its producing tracts should be exhausted some three years or more later. This Court, in discussing which of these tracts might enter into the rate base in computing a fair return for the service of furnishing gas to the affiliated company, said (pp. 406–407):

> There will be no need in the computation of the rate base to include the market or the book value of fields not presently in use, unless the time for using them is so near that they may be said, at least by analogy, to have the quality of working capital. * * *

> Leases bought with income, the proceeds of the sale of gas, and thus paid for in last analysis through the contributions of consumers, ought not in fairness to be capitalized until present or *imminent* need for use as sources of supply shall have brought them into the base upon which profits must be earned. To capitalize them sooner is to build the rate structure of the business upon assets held in idleness to abide the uses of the future. [Italics supplied.]

V

IF CERTAIN PROVISIONS OF THE COMMISSION'S ORDER SHOULD BE HELD INVALID, THE SEPARABILITY OF THE REMAINING PROVISIONS IS AN ADMINISTRATIVE QUESTION WHICH THIS COURT SHOULD NOT DECIDE

Certain of the provisions of the Commission's order which appellants attack are clearly severable from the remainder. The requirements that the charges to certain accounts shall be just and reasonable is of this nature. There is also no inseparable link between the particular classifications of physical property prescribed by the order and its other provisions. As to the part of the order relating to original cost, this is composed of a number of different provisions assailed on diverse grounds. There seems no present occasion to discuss separability from the standpoint of the possible invalidity of each provision under attack or any combination of such provisions.

To what extent the invalidity of a particular provision, or particular provisions, of the Commission's order would leave such gaps in the system of accounts as to render it unworkable is a question calling for the exercise of administrative judgment. The situation is somewhat different when a court declares the invalidity of certain provisions of a statute. If it merely strikes down the invalid provisions, those charged with enforcement of the statute will be under a duty to carry out the remainder. There is thus presented a question of statutory interpretation which it may be proper for the court to determine, namely, whether the legislative body did or did not intend that the valid provisions should remain effective notwithstanding the failure of those found to be invalid.

In the case of an administrative order such as is now before the Court, a decision limited to the holding that particular provisions are invalid leaves the regulatory body free to decide the question of separability in the light of its specialized knowledge of the administrative problems involved. The Communications Commission has no desire to put into effect an incomplete or inconsistent system of uniform accounts. What it does desire is that it should be permitted to decide in the first instance what does or does not constitute an incomplete or inconsistent system. We submit that the Court should not proceed on the assumption that the Commission will be wanting in a due regard for its responsibilities and duties or in the capacity to perform them.

CONCLUSION

It is respectfully submitted that the decree of the District Court should be affirmed.

STANLEY REED,
Solicitor General.
JOHN DICKINSON,
Assistant Attorney General.
CHARLES H. WESTON,
Special Assistant to the Attorney General.

NOVEMBER, 1936.

APPENDIX

The Act of June 19, 1934, 48 Stat. 1064 (U. S. C., Title 47, Secs. 151 *et seq.*), provides *inter alia:*

SEC. 3. For the purpose of this Act, unless the context otherwise requires—

* * * * *

(h) "Common carrier", or "carrier" means any person engaged as a common carrier for hire, in interstate or foreign communication by wire or radio or in interstate or foreign radio transmission of energy, except where reference is made to common carriers not subject to this Act; but a person engaged in radio broadcasting shall not, insofar as such a person is so engaged, be deemed a common carrier.

* * * * *

SEC. 205. (a) Whenever, after full opportunity for hearing, upon a complaint or under an order for investigation and hearing made by the Commission on its own initiative, the Commission shall be of opinion that any charge, classification, regulation, or practice of any carrier or carriers is or will be in violation of any of the provisions of this Act, the Commission is authorized and empowered to determine and prescribe what will be the just and reasonable charge or the maximum or minimum, or maximum and minimum, charge or charges to be thereafter observed, and what classification, regulation, or practice is or will be just, fair, and reasonable, to be thereafter followed, and to

make an order that the carrier or carriers shall cease and desist from such violation to the extent that the Commission finds that the same does or will exist, * * *.

* * * * *

SEC. 213. (a) The Commission may from time to time, as may be necessary for the proper administration of this Act, and after opportunity for hearing, make a valuation of all or of any part of the property owned or used by any carrier subject to this Act, as of such date as the Commission may fix.

* * * * *

(c) The Commission may at any time require any such carrier to file with the Commission a statement showing the original cost at the time of dedication to the public use of all or of any part of the property owned or used by said carrier. * * *

* * * * *

SEC. 214. (a) No carrier shall undertake the construction of a new line or of an extension of any line, or shall acquire or operate any line, or extension thereof, or shall engage in transmission over or by means of such additional or extended line, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity require or will require the construction, or operation, or construction and operation, of such additional or extended line * * *.

* * * * *

SEC. 221. (a) Upon application of one or more telephone companies for authority to consolidate their properties or a part thereof into a single company, or for authority for

one or more such companies to acquire the whole or any part of the property of another telephone company or other telephone companies or the control thereof by the purchase of securities or by lease or in any other like manner, when such consolidated company would be subject to this Act, the Commission shall fix a time and place for a public hearing upon such application * * *. After such public hearing, if the Commission finds that the proposed consolidation, acquisition, or control will be of advantage to the persons to whom service is to be rendered and in the public interest, it shall certify to that effect; and thereupon any Act or Acts of Congress making the proposed transaction unlawful shall not apply. * * *

* * * * *

SEC. 402. (a) The provisions of the Act of October 22, 1913 (38 Stat. 219), relating to the enforcing or setting aside of the orders of the Interstate Commerce Commission, are hereby made applicable to suits to enforce, enjoin, set aside, annul, or suspend any order of the Commission under this Act * * *, and such suits are hereby authorized to be brought as provided in that Act.

* * * * *

SEC. 501. Any person who willfully and knowingly does or causes or suffers to be done any act, matter, or thing, in this Act prohibited or declared to be unlawful, or who willfully and knowingly omits or fails to do any act, matter, or thing in this Act required to be done, or willfully and knowingly causes or suffers such omission or failure, shall, upon conviction thereof, be punished for such offense, for which no

penalty (other than a forfeiture) is provided herein, by a fine of not more than $10,000 or by imprisonment for a term of not more than two years, or both.

SEC. 502. Any person who willfully and knowingly violates any rule, regulation, restriction, or condition made or imposed by the Commission under authority of this Act, * * * shall, in addition to any other penalties provided by law, be punished, upon conviction thereof, by a fine of not more than $500 for each and every day during which such offense occurs.

* * * * *

SEC. 504. The forfeitures provided for in this Act shall be payable into the Treasury of the United States, and shall be recoverable in a civil suit in the name of the United States, * * *.

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